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Exit Focus
The deal process

Exit Focus Series
Part four of five

Part four of the series discusses the process of moving from negotiation to closing the deal and ways to avoid pitfalls along the way.

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Introduction

Navigating uncharted territory

As the fourth in our Exit Focus Series, *The deal process* discusses getting from negotiation to closing and ways to avoid pitfalls.

In business, every day presents new challenges, yet the seasoned business owner is rarely faced with the complete unknown. Using experience and judgment as compasses, an owner generally feels as they are on steady ground, knowing how to proceed. Yet, when an owner seeks to sell their business, there may not be familiar guideposts to lead the way. An owner's judgment can be influenced by the emotions connected to their business, which can lead to a less than optimal sale process. This installment highlights key considerations that will enable a business owner to retain control over the process while maintaining speed—two factors essential for a successful outcome.

The fifth and final installment, *Preparing for life after the deal*, will discuss how to preserve and transfer the wealth generated by the exit from your business.

Need to talk?

Whatever stage of transition your company is at, we can help you make the complex decisions that need to be made, understand the process and choose the right option to help you realize the value of your business and achieve your long-term vision.

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Executive summary

Ready, set, wait

You've made the decision to sell the business, considered the type of sale that would work best, engaged an independent deal advisor to manage the sale, and have built a package to present to potential buyers. Now you're ready to begin the actual sale process—or are you?

Courting potential buyers and managing the information flow

At this point, you're prepared to begin interactions with potential buyers. Success from this point forward largely depends on a balance of speed and control over the process, and part of this control involves carefully managing interactions with potential buyers.

Making the choice

Once you've selected a final bidder, you've lost most of your leverage. Making the choice is the most important decision you'll make in the process.

Negotiating and getting to closing

When negotiating the purchase and sale agreement, make sure you understand all of the buyer's issues. Understand what factors are important to the buyer, compare them to the factors that are important to you and formulate a negotiation strategy accordingly.

Ten tips for making the deal

Tips to keep in mind to ease the process of making the deal and help to avoid classic mistakes.

Ready, set, wait

Evaluate what has been learned during planning and compare it with the objectives articulated at the start of the process.

You've made the decision to sell. You've considered the possible types of buyers and the type of sale that will work best. You've considered the value of the business and geared up for the actual sale process, building a package to present to potential buyers. Now you're ready to approach potential buyers and begin the actual sale process. Or are you?

Revisit specific transaction objectives and priorities

Before you give the green light to begin the sale process, first evaluate what has been learned during planning and compare it with the objectives articulated at the start of the process.

Contemplate the following:

- Are your objectives still clear? Have you prioritized them? Have you taken all stakeholders into consideration? Does your plan still meet your objectives? Have you considered your options and alternatives?
- Have there been any relevant transactions in your sector to use as benchmarks?
- Do you understand the types of potential buyers and why each would find value in your business?
- Do you feel confident you will be able to answer in-depth buyer questions and provide supporting data as necessary?
- Does your idea of value correspond with the likely opinion of potential acquirers? If not, how do you plan to bridge the gap?

Even if you're clear about answers to the preceding questions, you still need to ask yourself:

- Is it still the right time to sell?
- Have you adequately prepared for the time commitment and resources that the selling process will require? Have you lined up sufficient internal resources and external advisors to provide needed expertise?
- Have you developed a specific, comprehensive, and realistic sales timeline?

Consider timing and market conditions

Before you give the "go" signal, reconsider your plan in light of current market conditions. Has the market outlook changed since you initiated the process and articulated your divestiture strategy?

For example, if market conditions have become more difficult, you'll need to be realistic about the effects on your sales process. In this case, valuation may be lower than you originally anticipated, and the process may move more slowly than in a strong market. Buyers will ask more questions, perhaps more difficult ones. You need to ask yourself: in light of current market conditions, is it still the right time to sell?

Perhaps you will decide to wait, and if so, the decision should not deter the company from its overall strategy. Management should use the opportunity to continue to manage the business for the future and to strengthen operating performance over the interim period. At this point in the process, you should still be running the business as if you're not going to sell, to minimize disruption and maintain operating momentum. So a decision to delay the sale should have minimal impact.

Line up internal resources and outside expertise

Private company business owners often underestimate how time-consuming and resource committing the sale process is. In doing so, two things can go wrong: the owner may not commit enough time to adequately maintain control over the sales process, or the owner may be so preoccupied with the sale process that inadequate attention is given to running the business. It is critical to understand and plan for the internal resources that will be needed to support the transaction, and to supplement them with outside advisors.

Bring in a team of trusted independent deal advisors early in the process to provide insight, objectivity, and guidance in many complex areas, including:

- Legal
- Corporate finance/valuation analysis
- Process management support
- Broker/dealer services
- Sell-side due diligence
- Accounting expertise
- Corporate and personal or estate taxes
- Specialty advice—for example, environmental/risk, industry
- Performance improvement

Structure the deal from a tax perspective

Every deal is different, and a tax advisor can tailor effective solutions for the business and its owners. Too often, a sale process has reached the letter-of-intent stage before tax advisors are consulted, and at that point many areas have already been negotiated, meaning tax-efficient alternatives may no longer be options. This may cause the seller to lose the chance to present beneficial structuring alternatives to the buyer. Further, changing the tax strategy at this stage may jeopardize the expected value to both buyer and seller, and put the underlying transaction itself at risk.

Developing tax strategies early is an important strategy for a seller to remain in control of the selling process. The usual strategy is to defer tax gain whenever possible, to allow the seller the benefit of the cash proceeds immediately while postponing the need to pay related taxes until a later date.

Determine a specific sales timeline

To maintain speed and control of the sale process, before potential buyers are contacted, you should develop an execution plan and a timeline that addresses the following items/actions:

- Strategic objectives and process management
- Drafting of company descriptive materials
- Performance of sell-side due diligence
- Preparation of management presentations
- Buyer due diligence
- Legal documentation and closing

Courting potential buyers and managing the information flow

For strategic buyers, sellers may want to consider current or potential competitors, suppliers, or even customers. For financial buyers, sellers might start by looking to those financial buyers that have portfolio companies in similar lines of business or industry.

By now, your company's descriptive materials and data room are ready—and you're prepared to begin interaction with potential acquirers. From this point forward, success depends largely on a balance of speed and control over the process. Part of this control involves carefully managed interactions with potential buyers.

Identifying and connecting with potential buyers

By this point in the process, the seller will have already evaluated the likely potential advantages and disadvantages of financial and strategic purchasers, and how the differences will likely affect objectives and potential outcome. Now is the time to identify specific potential buyers. For strategic buyers, sellers may want to consider current or potential competitors, suppliers, or even customers—anyone who might seek vertical integration or other synergy. For financial buyers, sellers might start by looking to those financial buyers that have portfolio companies in similar lines of business or industry. For some companies, it may seem like a simple process to identify likely acquirers, but consider that your independent deal advisors can tap their local and global networks to identify a fulsome list of potential acquirers.

Depending on the number of potential acquirers, a seller may opt to contact a handful of specific buyers individually or arrange an auction. Most sellers will try to focus their efforts on 25 or fewer potential buyers, then narrow the focus to those who are the most serious and whose proposed transaction terms are most attractive. A deal advisor may segment the process to optimize the flow of information throughout the selection and preliminary negotiation period.

Once the seller has identified the initial pool of potential buyers, they should reach out to them and highlight why the company for sale is attractive. If potential buyers want to learn more, sellers should have them sign a nondisclosure agreement before providing further information. Once it has been signed and the seller is legally protected, the key becomes knowing how much information to provide and when to provide it.

Managing the flow of information

Strong process management ensures the right information is provided at the right time to help the seller maintain control of the deal process while supporting the buyer's decision-making process. When and how information is provided for buyers is a key element in maximizing value.

An effective process protects confidential information, maintains speed by avoiding unnecessary and repetitive explanations, enhances buyer interest, allows increased insight into the buyer's motives and key interests, and—ultimately—enhances value and gives the seller control over the process.

Once a nondisclosure agreement has been signed, the extent of information and level of detail should be balanced, providing enough to enable buyers to determine a fair value but limiting the amount of sensitive or competitive information disclosed. How is this balance achieved, and what information should be disclosed to whom?

If the potential buyer pool has been narrowed down to one or two parties, the seller generally gives those potential buyers much of the information they request.

The confidential information memorandum

The confidential information memorandum (CIM) is a document that captures a business's key information, which a potential buyer needs in order to determine its interest in pursuing an acquisition. The CIM contains an overview of the business, key growth opportunities, market share data, and competitive position. It also contains details on historical and projected financial performance, management background, product and business descriptions, operations, and sales and marketing. An effective and well-written CIM can be a strong facilitator in the selection phase of the selling process. Depending on the nature of the likely purchaser, a seller may not need to prepare a full CIM, but should nevertheless be prepared to assemble a comprehensive data pack.

The better a seller understands the type of buyers being targeted—whether financial or strategic—the better the seller can tailor the specific content and nature of the data provided. If potential buyers are financial, the CIM might include a background on the industry, because financial buyers may not be familiar with the seller's industry. However, if the targeted acquirer is already familiar with the business, much of that detail can be omitted.

Moving from the general to the specific

The seller can now provide the CIM to potential buyers who have expressed interest in learning more. The letter will set the timeline and details of the process, usually along with requesting a preliminary indication of value and any other information deemed necessary to the decision-making process.

The bid instruction letter should generally allow a limited time—perhaps three to four weeks—by which interested parties must respond with their preliminary indications of value and other conditions. If the seller is adequately prepared, it's generally best to move fast. Moreover, by setting the terms, the seller maintains control of the process. From a process perspective, the seller has the most leverage at this point, assuming multiple parties are interested in competing for the company.

At the end of the stated period, the seller should hopefully have received responses from a subset of those who received the CIM, with a range of indications of value. The seller may wish to disregard those bidding below an acceptable minimum or may decide to keep some of them in the process to enhance competition.

Managing access to the data room

The potential buyers kept in the process will be invited into the data room. Today, around 80 to more than 90 percent of deals are done using online data rooms. An online data room provides significant time efficiencies, as well as the ability to carefully control access to information. An online data room provides flexibility, allowing the seller to assess the bidder's level of interest overall and in specific areas by enabling the seller to see how much time each bidder has spent in the data room and where that bidder's attention was focused.

Depending on how robust the process is, the seller may not want to make all information available from the beginning. Instead, the seller may prefer to withhold more sensitive details until later in the process, when the pool of interested parties is narrower. Further, the seller may want to wait until buyers themselves ask for certain information before providing it.

A seller who drafts the agreement instead of waiting for the buyer to do so maintains control over the process.

Management presentations

As the pool of suitors narrows, the seller will invite the remaining ones to a face-to-face meeting with management. The management presentation will expand on information in the offering memorandum and give buyers the opportunity to ask questions. Generally, sellers should try to limit the amount of management access provided to buyers, as a way of controlling the process as much as possible and of allowing management to continue focusing on running the business.

Maintaining control as the stakes get higher

The final two or three bidders may be given full access to the data room, along with a seller-friendly draft of the purchase and sale agreement for their markup and comments prior to the selection of a final bidder. A seller who drafts the agreement instead of waiting for the buyer to do so maintains control over the process in a number of ways. The seller can set the tone based on personal objectives while comparing bidders and gathering insight into how each buyer will react or respond to specific provisions in the agreement. Although buyers will respond with their markups during the bidding process, the final bidder, once selected, will also almost always raise additional comments and negotiating points.

Making the choice

It's not as simple as price

On the surface, price may seem to be the easiest way to compare offers, but much more must be considered. Generally, there are three primary areas to consider: price, terms, and certainty to close. As the seller, you must determine which area is the most important to meet your originally stated objectives, since it is rare for one buyer to stand out from the pack in all three.

- **Price**
  Not every dollar is equal. A cash purchase price is generally preferable to a purchase price in stock. Earn-outs may allow the buyer to pay more, but they also introduce an element of risk.

- **Terms**
  The terms that are most important differ on every deal and with every seller. Important terms could include non-compete consulting arrangements post-close, management team continuity, continued employment of family members, and timing of the signing and closing. You must decide which are most critical to you to help differentiate between bidders.

- **Certainty to close**
  Given the effort you've undertaken and the resources you've expended as a seller, you should consider the bidder with the greatest certainty to close, as balanced against price and terms. Things to bear in mind include the bidders' financial wherewithal, their reputation in the marketplace, and whether they have the corporate infrastructure to enable them logistically to complete a deal. If you're not confident the selected buyer can follow through to closing, you should be hesitant to sign a letter of intent and thereby provide exclusivity.

Letter of intent

Once you've settled on your final bidder, you'll typically draft a letter of intent ("LOI") that sets out the key terms at a high level. Although an LOI is nonbinding, it can be helpful in laying out a baseline understanding of key terms to help move the parties closer to signing. If many of the key areas have already been addressed in the final bid letter, the final bidder may simply confirm certain terms and ask for a period of exclusivity to finalize any remaining confirmatory due diligence with respect to a wide range of areas—such as financial, legal, environmental, risk management, human resources, and tax issues—while simultaneously negotiating the purchase and sale agreement. The exclusivity period can range from 30 to 90 days, with 45 to 60 days the norm. Obviously, buyers want longer exclusivity, and sellers want shorter.

Negotiating and getting to closing

If you understand what factors are important to the buyer, you can compare with those that are important to you, and devise a negotiating strategy accordingly.

Negotiate clauses as a block as opposed to clause by clause

When negotiating the purchase and sale agreement, you want to make sure you understand all of the buyer's issues, to avoid getting picked apart bit by bit (sometimes referred to as "death by a thousand paper cuts"). If you understand what factors are important to the buyer, you can compare with those that are important to you, and devise a negotiating strategy accordingly. There are a significant number of possible negotiating points, such as indemnification, warranties, and purchase price adjustment clauses. There is much "horse trading" in the negotiating, and to the extent you can best understand the relative importance of the issues to the buyer, the better the likely outcome for you.

Don't underestimate the value of a seasoned deal advisor

It is essential for sellers to work closely with their mergers and acquisitions advisor to understand the purchase and sale document. Buyers often take unreasonable positions in negotiations, and under pressure to move forward, you may be tempted to accept those positions, to assume undue exposure, or to forgo a benefit that should normally be yours. Based on their experience in similar situations, advisors can provide objective guidance regarding whether or not the requests are reasonable. Advisors can assist you in deciding which terms to accept, when a compromise is appropriate, and when you should adamantly stick to your position. Terms and conditions have economic impact, and good advisors can help you prioritize the battles and fine-tune the final agreement.

Know when to walk away and when to make that final leap of faith

As you finalize the purchase and sale agreement, the negotiation will frequently boil down to a handful of key items where each side is hesitant to compromise. At this point, you need to dig down deep and decide whether you can stomach the last mile. The last step is typically the toughest, because almost every deal will require you to accept some terms that, at the outset, you did not anticipate having to accept. Before making the last leap, you should perform one last gut check.

Are the suggested terms too onerous, such that the stated objectives at the outset will no longer be achieved? Has the trust between the parties eroded through repeated re-trading of previously agreed terms? Do you foresee a poor ongoing relationship with the buyers post-close, such that the required partnering will be difficult to achieve? If you answer any of those questions affirmatively, it might indicate that you may not ultimately be able to consummate the deal. However, deals are products of compromise, and if you've been managing the process effectively and optimizing the result, you should feel good about the decision to move forward to signing and closing.

Ten tips for making the deal

Keeping these principles in mind can ease the process and help you avoid classic mistakes.

- **Mind the store.**
  The sale process consumes significant amounts of time, energy, and other resources. It is surprisingly easy for you—or your entire management team—to become so focused on managing the sale process that day-to-day demands of running the business are neglected.

- **Be sure everyone's on the same page.**
  The sale process is complex, requiring input from and effort by multiple individuals across all functions of the business. Unless everyone rows in the same direction, messages will be mixed and the process will bog down.

- **Get the right advisors and the right expertise.**
  As a business owner, you know your business and you're used to making the decisions. In a sale, however, you're navigating uncharted waters, and consulting with an advisor may allow for a much smoother process.

- **Manage the business right up until closing.**
  Don't assume too early that a deal is done and start focusing energy on your life afterwards—dreaming of retirement and relaxing on the beach. This can lead you to stop managing the business effectively or to stick with a deteriorating deal simply because you're already emotionally committed to the life you've envisioned after the deal. Some deals will never go through, and it's important to hit projections.

- **Value your business on its own merits.**
  Once you hear "what another guy got" for the sale of his business, you might not be content with a lower offer for your business, even though it may be optimal or appropriate given the circumstances. Every deal is unique, and the stories you hear rarely include information about the many differences between the two businesses.

- **Know that dollars are not the only factors.**
  You may be tempted to jump into the deal process upon receiving an enticing offer. However, a promise of more money with more contingencies is not always the preferred route. Take time to understand the present value of structured components of consideration, such as seller paper or earn outs, and the associated risks. Investigate whether the potential buyer has a good track record of sticking with original offers.

- **Keep the circle of knowledge as small as possible.**
  News of an impending sale can make employees nervous and give competitors the opportunity to take away market share. You don't want someone whispering in someone's ear, "You don't want to use them. They're about to be sold."

- **Keep your options open.**
  Competition is a good thing. It's possible to waste a great deal of time and money in the deal process with a buyer who makes an exciting initial offer but later on shows no intention of closing the deal at that price or on those terms. Meanwhile, you may have let other suitors fall away or taken your eye off company operations, only to see the deal fall apart. Speed is good—but not for speed's sake.

- **Be up front about potential issues.**
  If a potential buyer finds out negative information late in the game, it could result in a significant reduction in the price and could jeopardize the transaction itself. Present yourself and your company accurately, remembering that numbers and facts that stick are always better than ones that erode.

- **Be prepared.**
  Don't rush to market. Lack of adequate preparation before beginning the selling process is always a major pitfall. Optimizing value and getting to closing requires that you put your best foot forward, make your presentation polished and complete, and be prepared for questions.

Life after the deal

The next and final installment of this series, Life after the Deal, will discuss estate and tax planning considerations, ways of handling the effects of various exit strategies, and dealing with personal wealth issues effectively
after the sale.

About PwC's Private Company Services

More than 65% of PwC Canada's clients are private companies, ranging from high net worth individuals to owner-managed family businesses and large, professionally-managed businesses. PwC's Private Company Services (PCS) group is a dedicated team of business advisors who help private company owners resolve day-to-day business issues and achieve long-term success. PCS offers the perspective of a third party with professional industry knowledge, business consulting, tax and accounting expertise.

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